

**California Debt and Investment Advisory Commission  
with California Association of School Business Officials**

**The ABCs of School Debt Financing**  
**Basic School Financing Techniques and Process:**  
**PART ONE**

**Lease Financing Structures**

**Tax and Revenue Anticipation Notes (TRANs)**

**Mello-Roos Special Tax Bonds**

September 21, 2004 - Sacramento

September 28, 2004 - Anaheim

# **Lease Financing Structures**

# What is Lease Financing?

- ◆ **Financing mechanism permitting a school district (lessee) to finance property to be repaid with lease payments**
- ◆ **Generally available to finance any school district project or property / equipment acquisition over time *without* voter approval**

# What is Lease Financing?

◆ **Lease financings are usually structured using the following:**

 **Direct Lease**

 **Certificates of Participation (“COPs”)**

 **Lease Revenue Bonds**

# Direct Lease

- ◆ **Ideal for acquisition of equipment, buses and relocatable classrooms**
- ◆ **Vendor, Leasing Company or Bank serve as lessor**
- ◆ **Term equals useful life of leased asset (3-10 years)**

# Direct Lease

- ◆Secured by the general fund -  
no new revenue source created
- ◆Not appropriate to finance O&M expenses
- ◆Funding process can be completed in  
30 days

# Certificates of Participation

- ◆ Ideal for construction of school facilities and acquisition of land or refinancing of existing leases
- ◆ Lessor is generally a non-profit corporation or joint powers agency
- ◆ Lessor assigns collected lease payments to COP owners (investors) to repay debt

# Certificates of Participation

- ◆ **Lease Term equals useful life of leased asset (5-30 years)**
- ◆ **Secured by lease payments made by school district for the use of the facilities or equipment**
- ◆ **Generally secured by School District's general fund - no new revenue source is created**



# Certificates of Participation

- ◆ **May be structured with a blended pledge of revenues - General Fund, Mello-Roos and Redevelopment**
- ◆ **Useful mechanism for “Bridge Financing” prior to receipt of State Funds or GO bond proceeds**
- ◆ **Can be structured and sold within 75 days**

# Lease Revenue Bonds

- ◆ **Very similar to COPs (uses, lease term, financing process)**
- ◆ **Issued by Joint Powers Authority or Non-Profit Corporation as the lessor**
- ◆ **Useful for pooling financings with different revenue streams**

# Lease Financing Structures: **Advantages**

- + No voter approval required**
- + Significant flexibility because of lack of procedural and other restrictions**
- + Can be accomplished in a relatively short time**
- + Can finance virtually any real or personal property**

# Lease Financing Structures: Disadvantages

- **Does not generate additional revenue to pay debt service**
- **More complex and less secure than general obligation bond financing, interest rates and costs of issuance are higher**
- **COPs/Lease Revenue Bonds require reserve fund for investor security**

# **Tax and Revenue Anticipation Notes ("TRANs")**

# What are TRANs?

- ◆ **Taxable or Tax-Exempt Short Term Borrowings**

- ◆ **Cash Flow Borrowings (primarily)**

  - ☞ **Cover Temporary Cash Flow Deficits**

  - ☞ **Arbitrage Earnings Potential**

# How Do TRANs Work?

- ◆ May be used for current expenses, capital expenditures and investment and reimbursement
- ◆ Temporary advance against projected taxes and other revenues
- ◆ Payable from revenues of the fiscal year in which TRAN is issued

# How Do TRANs Work?

- ◆ **No voter approval required**
- ◆ **State and Federal tax laws strictly govern TRAN issuance and borrowing amount**
- ◆ **May provide additional revenue if TRAN proceeds are reinvested - *arbitrage* earnings**



# What is Arbitrage?

## Arbitrage

 **Borrow at low, Tax Exempt Rates**

 **Reinvest at higher, Taxable Rates**

**1.50%\* Tax Exempt Borrowing Rate**

**3.50%\* Taxable Investment Rate**

**2.00%\* Arbitrage Earnings (Profit)**

**\*Not indicative of current market rates**

# TRANS: Advantages

- + Provide a source of funds for temporary cash deficits**
- + Only method of borrowing for working capital authorized by statute**
- + Simple and inexpensive - State and County Pools**
- + No voter approval required**
- + Permits arbitrage earnings to be kept if certain borrowing and expenditure requirements are met**

# TRANS: Disadvantages

- **Generates no additional revenue (except permitted arbitrage earnings)**
- **Size of borrowing is restricted**
- **Only revenues received or attributable to the fiscal year in which the TRANS are issued may be pledged for repayment**

# **Mello-Roos Special Tax Bonds**

# What is Mello-Roos?

- ◆ **Senator Henry Mello and Assemblyman Mike Roos authored the Mello-Roos Community Facilities District Act of 1982**
- ◆ **The Act authorizes the creation of community facilities districts (“CFD”), levy of special tax and issuance of special tax bonds**
- ◆ **CFDs are voter approved (landowner or registered voter) and create additional tax revenues**

# What Can Mello-Roos Fund?

- ◆ **Long-term bonds secured by special taxes (30 years)**
- ◆ **Finances land acquisitions, relocatables, furniture, buses, building construction and improvements, and certain equipment**

# What Can Mello-Roos Fund?

- ◆ **Funds services e.g. recreation programs, library services, O&M for museums and cultural facilities**
- ◆ **Can be used to allow developers to fund their developer fees**

# Special Taxes & Bonds

- ◆ **Special taxes levied within a specific geographic area(s) within school district**
- ◆ **Special taxes levied according to Rate and Method of Apportionment (RMA)**
- ◆ **The RMA sets forth the manner in which special taxes are levied (e.g. acre, parcel, square footage or zoning designation)**



# Special Taxes & Bonds

- ◆ **Special taxes levied annually at 1.10% of bond's debt service for added security**

**Tax = \$110,000   Debt Service = \$100,000   Surplus/Coverage = \$10,000**

- ◆ **Bonds secured by the special taxes and the taxable land within the CFD**
- ◆ **Bond amount constrained by value of taxed property and other taxes**

# Formation and Bond Sale Process

**The formation and bond sale process can be lengthy - 6 months to 12 + months**

## ◆ Step 1

 Adopt Goals and Policies

## ◆ Step 2

 Mitigation Agreement with Landowner

 Petition by Landowner

# Formation and Bond Sale Process

## ◆ Step 3

- 📄 Resolution of Intention to Form a Community Facilities District
- 📄 Resolution of Intention to Incur Bonded Indebtedness

## ◆ Step 4

- 📄 Approve Joint Financing Agreements (if applicable)
- 📄 Public Hearing
- 📄 Resolution of Formation / Calling Election
- 📄 Resolution Incurring Bonded Indebtedness / Calling Election
- 📄 Resolution Canvassing Votes
- 📄 First Reading of Ordinance

# Mello-Roos Formation and Bond Sale Process

## ◆ Step 5

- 📄 Second Reading of Ordinance

- 📄 Record Notice of Special Tax Lien

## ◆ Step 6

- 📄 End of Challenge Period

- 📄 Appraisal of Property (3:1 Ratio)

- 📄 Prepare Legal Documentation

## ◆ Step 7

- 📄 Resolution Approving Bond Sale and Financing Documents

- 📄 Sell and Close Special Tax Bonds

# Mello-Roos Special Tax Bonds: **Advantages**

- + Generate additional revenue to pay debt service and expenses**
- + Flexibility in establishing RMA**
- + Array of facilities that can be financed**
- + Ability to match financing needs to pace of growth due to new development in school district**

# Mello-Roos Special Tax Bonds: Disadvantages

- **Lengthy formation financing time frame**
- **2/3's registered voter approval required if there are 12 or more registered voters in the CFD**
- **Board must approve & levy special tax annually**
- **Board may be required to initiate foreclosure action against delinquent taxpayers**
- **Bonds are generally non-rated thus more higher interest costs**

# Questions



**The ABCs of School Debt Financing**  
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**PART TWO**

**General Obligation Bonds**

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# General Obligation Bonds

- ◆ A method of financing public school facilities
- ◆ Authorized by State Law
- ◆ Debt is Secured by Ad Valorem Taxes
  - 📄 Tax amounts determined based on property values (Proposition 13)

# Bond Approval System

## ◆ Two Methods Available Under State Law

 **Proposition 46 (1986)**  
**Required 2/3rds Favorable Vote**

 **Proposition 39 (2000)**  
**Requires 55% Favorable Vote**

**(Can Only Use One Method at a Time)**

# **School Facilities Improvement Districts (SFIDs)**

## **◆ Application - Limited Area of a School District**

**(Must exclude Mello-Roos districts  
which finance school facilities)**

## **◆ Procedural Requirements**

# Proposition 39

- ◆ **Approved by Voters on November 7, 2000**
- ◆ **Applies to School Districts, Community College Districts and County Offices of Education**

# Differences Between 2/3-Vote and 55%-Vote Elections

- ◆ **Types of Facilities**
- ◆ **Maximum Tax Rates**
- ◆ **Election Dates**
- ◆ **Accountability Measures**

# Types of Facilities

## ◆ 2/3 Vote

 Real property only (land, buildings, permanent improvements)

## ◆ 55% Vote

 All improvements, including furnishings and fixtures.  
Also includes leases.


## ◆ No Teacher/Administrator Salaries or Operating Expenses

# Maximum Annual Tax Rates

◆ **2/3 Vote: No limit**

◆ **55% Vote**

 **\$25 per \$100,000 of assessed value for community college districts**

 **\$30 per \$100,000 of assessed value for elementary and high school districts**

 **\$60 per \$100,000 of assessed value for unified school districts**


# Election Dates

## ◆ 2/3 Vote

 Any Tuesday, except within 45 days of a statewide election

## ◆ 55% Vote

 March and November of even-numbered years

 Other dates eligible only if coincide with regularly-scheduled district-wide election



# Accountability Measures

## ◆ 2/3 Vote

 None required

## ◆ 55% Vote

 Citizens oversight committee

 Performance and financial audits

# Bonding Capacity and Tax Rate Limitations

- ◆ **Statutory Bonding Capacity Limits**  
**Amount of Bonds Sold in Fiscal Year**
- ◆ **Proposition 39 Constrains**  
**Voter-Approved Bond Amount**

# **Statutory Bonding Capacity Limits Amount of Bonds Sold in Any Fiscal Year**

- ◆ 1.25% of assessed value for elementary and high school districts**
- ◆ 2.50% of assessed value for unified school districts**
- ◆ 2.50% of assessed value for community college districts**

# **Proposition 39 Constrains Voter-Approved Bond Amount**

- ◆ **Annual limits to tax rates reduce effective bonding capacity by about 50%**
- ◆ **Significant constraint for school districts with small tax base**

# Length of Bond Repayment for General Obligation Bonds




## ◆ 25 years most common repayment period

 Allows level or escalating bond payments

## ◆ 30- to 40-year repayment periods less common

 Level bond payments required

# Number and Frequency of Bond Issues

- ◆ **Effects on tax rate and bond amount**
- ◆ **Importance of initial bond issue**
- ◆ **Flexibility to account for ongoing adjustments**
  -  **Project timing**
  -  **Assessed value growth**
  -  **Bond interest rates**

# Upcoming Proposition 39 Election Dates

◆ **November 2004**

◆ **March 2006**

◆ **Other dates only if coincide with regularly scheduled district-wide election**

- **School Board election**
- **County election**
- **Special District election**
- **Community College election**

# Upcoming 2/3 Vote Election Dates

◆ Any Tuesday

◆ June 2005

◆ November 2004

◆ November 2005

◆ March 2005

◆ March 2006



# General Obligation Bonds: **Advantages**

- + Generates additional revenue to pay debt service**
- + Lower interest rate and costs of issuance because of strength of security and simplicity of structure**
- + No need to issue more bonds to create a reserve fund**
- + No need to issue more bonds to fund interest on the bonds during the project construction period**

# General Obligation Bonds: Disadvantages

- **Voter approval required (2/3's or 55%)**
- **Debt limit restrictions**
- **Election requirements impose long delay between initiation of proceedings and school district's receipt of bond proceeds**
- **Tax must be levied based on a uniform percentage of the assessed value of each parcel; no flexibility in establishing the tax formula**

# Questions

